

**STATE OF NEW JERSEY**  
**Board of Public Utilities**  
*Two Gateway Center*  
*Newark, NJ 07102*

ENERGY

IN THE MATTER OF GPU ENERGY'S	)	
ASSIGNMENT OF AN INTEREST IN A	)	
PORTION OF ITS MERRILL CREEK WATER	)	DECISION AND ORDER
STORAGE AND RELEASE ENTITLEMENTS	)	
TO FPL ENERGY MARCUS HOOK, L.P.	)	DOCKET NO. EF01030142

(SERVICE LIST ATTACHED)

BY THE BOARD:

By letter dated March 2, 2001, Jersey Central Power & Light Company, doing business as GPU Energy ("GPUE" or "Company") filed a petition with the Board of Public Utilities ("Board") to approve, pursuant to N.J.S.A. 48:3-7, an assignment to FPL Marcus Hook, L.P. ("FPL") of an interest in a portion of GPUE's entitlement in the Merrill Creek Reservoir Project ("Merrill Creek"). The Company is also requesting, pursuant to N.J.A.C. 14:1-5.6(i), a waiver of the Board's advertising requirement set forth in N.J.A.C. 14:1-5.6(b). A copy of the petition was served upon the Division of the Ratepayer Advocate ("Advocate").

Background

Merrill Creek, located in Harmony Township, New Jersey, was developed by GPUE and the other co-owners of Merrill Creek (collectively, "Co-Owners")<sup>1</sup> in the mid-1980s to provide compensation releases ("Make-Up Water") to the Delaware River, pursuant to the requirements of the Delaware River Basin Commission, to compensate for the Delaware River Basin water consumed during times of drought by the electric generating stations of the Co-Owners situated in the Delaware River Basin. Merrill Creek consists of a 650-acre reservoir with about 48,000 acre-feet of water storage capacity on approximately 2,000 acres of real estate, a dam, dikes, a pump house, pumps, pipeline and related works and appurtenant equipment and facilities.

By Order dated June 2, 1988, in Docket No. EM88040588, the Board, among other things, authorized GPUE to sell and lease back its 8.37% interest in Merrill Creek ("Merrill Creek Lease"). The Company now holds an 8.37% leasehold interest in the reservoir area of Merrill Creek, along with the related water storage and release entitlements of approximately 4,000 acre-feet of storage capacity. GPUE's initial lease agreement expires on December 31, 2032, but contains renewal and repurchase options, which can be exercised by the Company at the time of expiration of the Merrill Creek Lease.

In the early 1990s, GPUE revised its plans to build base load capacity in the Delaware River Basin as the result of less-than-expected load growth and the Company's utilization of alternative capacity sources. As a result, GPUE's entitlement to Merrill Creek releases was

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<sup>1</sup> The other Co-Owners and their respective ownership or leasehold interests are: Delmarva Power & Light Company – 11.909%; Metropolitan Edison Company – 8.370%; Philadelphia Electric Company – 44.241%; Public Service Electric and Gas Company – 13.906%; Atlantic City Electric Company – 4.834%; and Pennsylvania Power & Light Company (through a subsidiary) – 8.370%.

substantially in excess of the Company's then current and projected requirements. Consequently, pursuant to Board authorization granted by Order dated December 30, 1992, in Docket No. EF92111065 ("December 1992 Order"), GPUE subleased a portion of its excess water storage capacity to Keystone Energy Service Company or its affiliate(s) ("Keystone"). Specifically, beginning July 1995, GPUE sublet 135 acre-feet of water storage capacity annually and also made available to Keystone an additional 135 acre-feet of GPUE's Make-Up Water not being used by the Company, if required by Keystone for Make-Up Water purposes. Accordingly, GPUE entered into a sublease agreement dated May 1, 1993 with Granite Water Supply Company, Inc. ("Granite Sublease"), an affiliate of Keystone.

Pursuant to Board authorization granted by Order dated December 6, 1993, in Docket No. EM93090386 ("December 1993 Order"), GPUE subleased an additional portion of its excess water storage capacity to Northampton Water Supply, Inc., or its affiliate(s) ("Northampton") pursuant to a sublease agreement ("Northampton Sublease") with terms similar to the Granite Sublease. Therefore, beginning in July 1995, GPUE sublet 135 acre-feet of water storage capacity annually and also made available to Northampton an additional 135 acre-feet of water storage capacity, as well as any additional share of GPUE's Make-Up Water not being used by the Company, if required by Northampton for Make-Up Water purposes.

In 1999, GPUE sold essentially all of its non-nuclear generation assets, including its ownership interest in the Gilbert Station ("Gilbert"), to Sithe Energies, Inc. ("Sithe"). In connection with the sale of Gilbert, GPUE sublet 251 acre-feet of water storage capacity to Sithe for the operation of Gilbert and also made available to Sithe the option to sublease additional water storage capacity from time to time ("Sithe Sublease").

GPUE asserts that its approximate 4,000 acre-feet of usable water storage capacity in Merrill Creek is substantially in excess of the Company's needs to provide water storage capacity pursuant to the Granite Sublease, the Northampton Sublease, the Sithe Sublease and any other GPUE current and projected requirements. The Company is seeking Board authorization to assign and transfer to FPL, or an affiliate thereof, pursuant to an executed Assignment of Entitlement Agreement dated January 29, 2001 ("Entitlement Agreement"), the right to utilize an interest in a portion of GPUE's entitlement to provide water storage capacity for Make-Up Water purposes with respect to FPL's operations at MH700 Plant in Marcus Hook, Pennsylvania, or other generation facilities now or to be constructed by FPL ("FPL's Operations").

Under the terms of the Entitlement Agreement, GPUE will annually allocate 620 acre-feet of Make-Up Water ("Committed Capacity") to FPL. GPUE will also make available to FPL such amount of additional capacity not being used by the Company, if required by FPL for Make-Up Water purposes ("Additional Capacity") ("Committed Capacity" and "Additional Capacity" constitute "Capacity"). The term of the Entitlement Agreement is for a period of thirty years from commencement, ending no later than December 31, 2032, when GPUE's lease agreement expires. In addition to requiring Board approval, the Entitlement Agreement is subject to the Co-Owners' right of first refusal under the Merrill Creek Owners Agreement.

Also, under the terms of the Entitlement Agreement, in return for the allocation of Committed Capacity to FPL's Operations, FPL agrees to pay \$581,250 per contract year<sup>2</sup> to GPUE, in two equal semi-annual installments of \$290,625, on each January 2 and July 2, subject to proration

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<sup>2</sup> "Contract year" is defined in the Entitlement Agreement as each 12 month period (or such shorter period as appropriate from the commencement date to be beginning at the first complete contract year and from the end of the last complete contract year to the expiration of the base term) from the commencement date to the expiration date, beginning on January 1 and ending on the following December 31.

for partial contract years. In addition, upon execution of the Entitlement Agreement, FPL deposited a commitment deposit in the sum of \$100,000 with GPUE, \$50,000 of which will be credited upon commencement of services to reduce FPL's payment obligations. To the extent that FPL utilizes Additional Capacity in any year, the terms of payment for the allocation and use of the Additional Capacity shall be negotiated in good faith at the time said capacity is needed. In addition, FPL agrees to pay its allocable share of GPUE's Merrill Creek operation and maintenance costs, and certain other expenses associated with replenishing amounts of reservoir storage water released from Merrill Creek.

GPUE asserts that the payments for the Committed Capacity have been structured to at least equal, during the term of the Entitlement Agreement on a present value basis, a prorated portion of GPUE's rent payments under the Merrill Creek Lease. The Company asserts that it intends to apply the payments for the Committed Capacity to its rental obligations under the Merrill Creek Lease or for other general corporate purposes.

Pursuant to N.J.A.C. 14:1-5.6(i), GPUE is also requesting a waiver of the advertising requirement set forth in N.J.A.C. 14:1-5.6(b). The Company asserts that waiver of this requirement will not adversely affect the public interest, and that the assignment of the Entitlement Agreement to FPL will not affect GPUE's ability to render safe, adequate and proper service. GPUE asserts that no relationship exists between itself and FPL other than that of assignor and assignee. Lastly, GPUE asserts that, due to the unique nature of this transaction, particularly the fact that it involves a proposed assignment to a future owner of generation along the Delaware River having unique needs for water storage and release entitlements, there is believed to be no other market for the entitlement.

Board Staff ("Staff") conducted informal discovery with GPUE to clarify, among other things, the application of the remaining 50% of FPL's \$100,000 deposit and the calculation of the Entitlement Agreement payment. The Company advised Staff that the remaining \$50,000 of FPL's deposit will be applied to GPUE's utility revenues for the benefit of customers. The Company also provided information showing that the annual levelized lease payment by the Company, on a present value basis, for the calendar years 2003 through 2032 is \$3,192,971 per year. According to the Company, the Entitlement Agreement represents 15.4% of GPUE's full entitlement in Merrill Creek which, on a prorated basis, would be \$491,718. The actual Entitlement Agreement payment of \$581,250 per year represents an additional annual payment by FPL of \$89,532, 18% above GPUE's lease payment.

By letter dated November 5, 2001, the Advocate submitted its comments in this matter. The Advocate states that it does not oppose the Company's request for a waiver from the Board's advertising requirement because of the uniqueness of the transaction. The Advocate recommends that, since the Company's current distribution rates include lease payments for Merrill Creek, any payments related to the Entitlement Agreement be credited to GPUE's currently underrecovered deferred balance. The Advocate also recommends that the "used and usefulness" nature of Merrill Creek be reviewed in the Company's next base rate case, given the fact the GPUE has divested itself of its generation assets.

### Discussion and Findings

As a preliminary matter, the Board notes that GPUE is requesting the Board's approval of this transaction between the Company and FPL pursuant to N.J.S.A. 48:3-7, which requires Board approval for a broad range of transactions not occurring during the ordinary course of business. In its December 1992 Order approving the Granite Sublease and, again, in its December 1993 Order approving the Northampton Sublease, the Board determined that those transactions were not in

the ordinary course of business and that Board approval was required in those instances. The Board HEREBY REAFFIRMS its determination in both the December 1992 Order in Docket No. EF92111065 and the December 1993 Order in Docket No. EM93090386 and applies its determination to the Entitlement Agreement as well.

Similarly, the Board notes that, in its December 1993 Order, the Board determined that the Northampton Sublease represented a specialized need of a future generation facility for water storage and release entitlements along the Delaware River which reflected the unique nature of the sublease. The Board found that the market for this type of transaction was extremely limited at that time and waived the advertising requirements set forth in N.J.A.C. 14:1-5.6(b). While market conditions for new generation facilities may have changed since the December 1993 Order was issued, GPUE still has significant entitlement rights to Merrill Creek, as discussed below, that remain uncommitted to present or proposed generation and, therefore, will continue to provide additional opportunities for other generation facilities that may be prospectively constructed in the Delaware River Basin for which GPUE has entitlement rights available for sublease. The Board therefore FINDS a waiver of the advertising requirements to be appropriate in this instance. Accordingly, the Board HEREBY WAIVES the advertising requirement set forth in N.J.A.C. 14:1-5.6(b).

The Board further FINDS that the assignment by GPUE of a portion of its entitlement in Merrill Creek to FPL is appropriate and reasonable, and in the public interest. GPUE's 8.37% leasehold interest in Merrill Creek, which terminates on January 31, 2032, represents an investment in a generation-related facility for which there appears to be no current or prospective use by the Company at this time, particularly in light of the Company's divestiture of essentially all of its generation assets.<sup>3</sup> As noted above, this matter represents the fourth in a series of subleases of the Company's Merrill Creek entitlement beginning in 1992, which collectively make use of 1,411 acre-feet, or about 35%, of the Company's approximate 4,000 acre-feet of water storage capacity, with additional capacity available to the sub-lessees on an as-needed basis.

The Board also reviewed the proposed level of compensation to the Company in return for subleasing a portion of the Company's Merrill Creek entitlement to FPL. The payment by FPL to GPUE in the amount of \$581,250 per year exceeds the pro-rated lease obligation of GPUE by 18%, thereby benefiting customers by making them whole for the Company's lease obligation for the subleased portion and by providing an additional offset to the Company's continuing lease obligation for the remaining balance of its lease entitlement. The Board notes that there is also an additional upfront payment by FPL in the amount of \$50,000, which represents the balance of a nonrefundable deposit provided by FPL to GPUE upon the execution of the Entitlement Agreement, which shall also be used to benefit customers. The Board FINDS that the \$50,000 deposit by FPL and the proposed annual payment by FPL of \$581,250 represent the fair rental value of the subleased portion of Merrill Creek as set forth in the Entitlement Agreement. For the foregoing reasons, the Board HEREBY APPROVES the Entitlement Agreement between GPUE and FPL.

In the Board's Final Decision and Order ("Final Order"), dated March 7, 2001, in the Company's rate unbundling, stranded costs and rate unbundling proceedings, Docket Nos. EO97070458, EO97070459 and EO97070460, the Board recognized the costs associated with GPUE's remaining leasehold interest in Merrill Creek as being included in the Company's previously bundled rates. In its Final Order, the Board approved continued recovery by GPUE of its Merrill Creek-related costs as a regulatory asset via the Company's unbundled distribution rates (Final

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<sup>3</sup> GPUE maintains a 50% ownership interest in the Yards Creek Hydroelectric Project, a 400-megawatt pumped storage hydroelectric facility located in Pahaquarry and Blairstown Townships, Warren County, New Jersey. The facility is self-contained, without any air or water emissions and is not dependent on the Delaware River Basin for water.

Order at 114). Notwithstanding this regulatory treatment, Merrill Creek is, in effect, a stranded asset associated with the Company's divested generation facilities, since it is no longer currently or prospectively used and useful for the Company's distribution-only operations.

Pursuant to N.J.S.A. 48:3-61(f), the Board is required to ensure that the Company takes all reasonably available measures to mitigate the level of its stranded costs. The Board FINDS that the proposed sublease of a portion of its interest in Merrill Creek is consistent with that requirement. Since customers are currently paying for the Company's remaining leasehold interest in Merrill Creek through their distribution rates, the Board believes that it is appropriate that customers receive the full value of the Entitlement Agreement revenues as an offset to such payments. Accordingly, the Board FINDS it appropriate for GPUE to credit all revenues associated with the Entitlement Agreement between the Company and FPL to the Company's market transition charge ("MTC") deferred balance. Therefore, the Board HEREBY DIRECTS the Company to credit the aforementioned \$50,000 balance of FPL's deposit and the full amount of FPL's semi-annual sublease payments to GPUE's MTC deferred balance upon receipt by the Company. The Board shall review the appropriate prospective accounting and/or ratemaking treatment of the Entitlement Agreement revenues in an appropriate subsequent rate proceeding.

DATED: November 8, 2001

BOARD OF PUBLIC UTILITIES  
BY:

(SIGNED)

CONNIE O. HUGHES  
PRESIDENT

(SIGNED)

FREDERICK F. BUTLER  
COMMISSIONER

(SIGNED)

CAROL J. MURPHY  
COMMISSIONER

ATTEST: (SIGNED)

FRANCES L. SMITH  
SECRETARY

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